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methods and policies used in making PATRONAGE REFUNDS by selected farmer cooperatives

by

DONALD
R.
DAVIDSON

U.S. Department of Agriculture

Farmer Cooperative Service

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FARMER COOPERATIVE SERVICE
U.S. DEPARTMENT OF AGRICULTURE
WASHINGTON, D.C. 20250

The Farmer Cooperative Service conducts research studies and service activities of assistance to farmers in connection with cooperatives engaged in marketing farm products, purchasing farm supplies, and supplying business services. The work of the service relates to problems of management, organization, policies, merchandising, product quality, costs, efficiency, financing, and membership.

The Service publishes the results of such studies; confers and advises with officials of farmer cooperatives; and works with educational agencies, cooperatives, and others in the dissemination of information relating to cooperative principles and practices.

Farmer Cooperative Service is indebted to the 18 regional associations for their cooperation in this study. The author is also indebted to David Volkin, Chief, Business Administration Branch, Management Services Division, Farmer Cooperative Service, and D. Morrison Neely, Deputy Director, Research and Operations Division, Office of General Counsel, for their substantial contributions to this manuscript.

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HIGHLIGHTS

Patronage refunds have long been a distinctive trademark of cooperative business. Nowhere have they been used more extensively than by our Nation's farmer cooperatives. Simply stated, patronage refunds are a basic tool for operating at cost and for returning savings to patrons. Such savings are the essence of agricultural cooperation.

A knowledge of methods and policies used by cooperatives in computing and distributing patronage refunds is vital to our understanding and evaluation of their effectiveness. Little has been done in recent years to study patronage refund practices, using either the commodity or the functional approach.

Officials of 18 farmer cooperatives were interviewed in the summer of 1965 as a preliminary step in such a cross-commodity or functional study. Some were officials of marketing associations; some, farm supply associations; some, a combination of both. All cooperatives were departmentalized to some extent. All were regionals; some of these were federated; some were centralized; and some were of mixed membership.

Although methods of computing and distributing refunds differed among 16 associations, they all confirmed the importance of patronage refunds in their operations. Two associations, however, considered their pooling practices unrelated to patronage refunds.

What are patronage refunds? Patronage refunds, also referred to as patronage dividends, are the amounts allocated to patrons based on their volume of business with the cooperative. Such allocations are made at the end of a fiscal year or other fixed period. They are net amounts left after all operating, overhead, and maintenance costs have been paid. These refunds are paid: (1) In cash; (2) in capital stock, revolving fund certificates, letters of advice, and the like; or (3) by crediting patrons' equity accounts without giving written notices of such allocations.

How are patronage refunds computed? Four major methods used by the cooperatives in computing patronage refunds were: (1) On a total business basis; (2) on a divisional basis; (3) on a departmental basis; and (4) a combination of methods.

What determines which method or methods are used? Rates of patronage refunds are generally more representative, and thus more equitable, when closely related to a product or homogeneous grouping of products than to dissimilar items that may produce margins of greater variability. Thus, as cooperatives expand and diversify operations, effective computation and distribution of patronage refunds become more of a problem.

On the basis of what is reasonable and practicable from a business standpoint, management must decide the extent of operational division necessary in computing patronage refunds.

How are patronage refunds distributed? Associations were more consistent in distribution of patronage refunds than in computation of them. General methods used included cash payments, written notices of allocation, or book credits without written notices.

More than 70 percent of the refunds made by the 12 cooperatives during the period studied were paid in cash. (The 6 remaining cooperatives did not recognize patronage refunds in their type of operations, incurred net losses, or did not distribute patronage refunds during the period studied.) The cooperatives retained about 30 percent for capital, although this amount was credited to patrons' accounts, with patrons receiving notices of the allocation. Common and preferred stock accounted for about 75 percent

of the value of noncash refunds. Letters of advice and certificates of various kinds made up the rest. Data in this report represent only a limited number of cooperatives and should not be construed as representative of cooperatives in general.

Of the 16 cooperatives operating on a patronage refund basis, 9 qualified under Section 521 of the Internal Revenue Code of 1954 for the different tax treatment. The 7 associations which did not qualify made patronage refunds only to members. In computing taxable income, both types of associations--those which qualified under Section 521 and those which did not--excluded qualified patronage refunds from their gross income.

In general, to "qualify" patronage refunds under the Revenue Act of 1962, a form of "patron consent" is required. Bylaw consent was the favored method of cooperatives in obtaining patrons' consent (or agreement) to treat the noncash portion of their refunds as income received. It was used by 11 of the 12 cooperatives. For nonmember patrons, cooperatives used either individual consent or qualified check (which represents at least 20 percent of total refund and is endorsed or cashed on or before a specified date and imprinted that such action constitutes consent) or both. Only one association omitted bylaw consent altogether and used qualified check for both members and nonmembers.

What problems arise from patronage refunds? Treatment of divisional and departmental losses, nonpatronage income, large vs. small patrons, small refunds, and depreciation were some of the problems reported.

METHODS AND POLICIES USED IN MAKING PATRONAGE REFUNDS BY SELECTED FARMER COOPERATIVES

By Donald R. Davidson
Management Services Division
Business Administration Branch

Patronage refunds have long represented one of the most practical means of returning net savings to members or to all patrons of a cooperative. The basic premise underlying patronage refunds is to provide services at cost. This is a fundamental principle of cooperation. Patronage refunds are employed by most cooperatives to assure operations on a cost basis. Certain types of pooling and pricing at cost are other methods used to accomplish the same goal.

Are patronage refunds as important to cooperatives today as they were 25 or 30 years ago? Have patronage refund procedures kept pace and adapted to changing conditions in the agribusiness economy? What are the current methods and policies being used by the Nation's cooperatives to distribute their net savings? What is the effect of recent tax legislation which has changed the tax treatment of cooperatives and their patrons? Where are the trouble spots, and what can be done?

These questions, of interest to most cooperatives, have prompted the Farmer Cooperative Service to study methods and policies now used by farmer cooperatives in making patronage refunds. Findings of this study will help in developing guidelines for cooperatives to evaluate and, where necessary, improve present patronage refund methods and practices.

OBJECTIVES AND PROCEDURES

As the initial phase of this study, the author personally interviewed management officials of 18 regional[1] cooperatives in 1965. Several of these cooperatives were major farm supply and marketing associations.

This report is based on information obtained from these interviews. It provides some insight into the handling of patronage refunds by a small but important segment of the cooperative population. It does not attempt to answer all the questions on the subject. It does seek to bring into clearer focus the nature of the patronage refund; how the refund is computed; how it is distributed; and what problems are involved. The report also contains a preview of research now underway which is based on data obtained from a 40 percent sample of all regional marketing and

[1] A regional cooperative is one that serves a district consisting of a number of counties, or a number of States. This includes all federated cooperatives--centralized associations serving more than 8 or 10 counties--and cooperatives with large volumes that are neither strictly federated nor strictly centralized as they have both local cooperatives and individual farmer members.

For more about regionals, see Statistics of Farmer Cooperatives (8). (Underscored numbers in parentheses refer to items listed in Literature Cited, p. 22.)

farm supply associations in the United States. Findings of this study will be published in a later report.

The 18 regional cooperatives were selected on the basis of their size, type and diversity of operations, location, and willingness to supply needed data. Table 1 shows the membership structure of the regionals used in the study. Large and small regionals, marketing products ranging from milk and rice to wool and tobacco, and selling a variety of farm supplies, were used.

Table 1.--Type and membership structure of the 18 regional cooperatives interviewed, for this study, August 1965

Major function	Membership structure			
	Centralized	Federated	Mixed[1]	Total
	Number			
Marketing ..	7	2	3	12
Purchasing. .	-	2	-	2
Diversified. .	1	2	1	4
Total	8	6	4	18

[1] Have both individual producers and cooperatives as members.

Figure 1 shows the approximate location of cooperatives supplying information for this report and the number of individual patrons they served--either directly or through local member cooperatives. Altogether, a little more than 1,000,000 patrons were served through the 18 associations.

The annual business volumes of the 12 cooperatives engaged mainly in marketing ranged from $700,000 to $55 million with a median volume of $10 million. The total business volumes of the 4 diversified cooperatives studied ranged from $62 million to $179 million in 1965. The two purchasing cooperatives were large federated farm supply associations with business volumes of $39 million and $122 million, respectively.

Cooperative management officials provided information on: (1) Proportion of net savings distributed as patronage refunds; (2) methods used in computing patronage refunds; (3) relationship of departmentalization[2] to patronage refunding; (4) media used in allocating and distributing refunds; and (5) effects of recent tax legislation on patronage refund practices. These officials were general managers, assistant and office managers, secretary-treasurers, directors of finance, and controllers.

Findings published in this report will provide farmer members and other patrons of cooperatives with information that will help them gain a better understanding of patronage refunds made by cooperatives. It will enable cooperative management to make better decisions about patronage-refund policies. It should be useful also to other people interested in the cooperative way of doing business, and to State and Federal researchers concerned with cooperative problems.

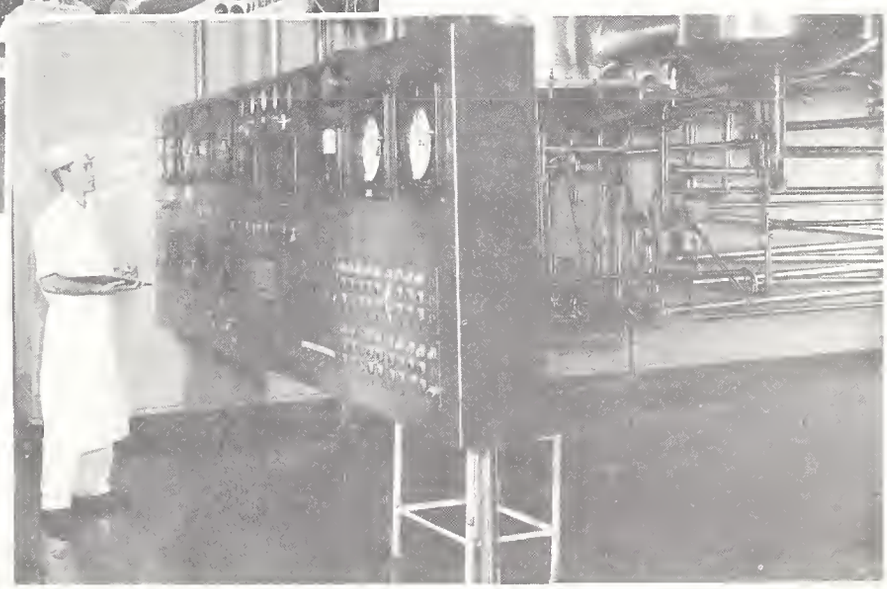
PATRONAGE REFUNDS DEFINED

The term "patronage refund" or "patronage dividend" is not as simple as it seems at first. What one association calls a patronage refund another may insist does not so qualify.

A cooperative, like any other form of business, must operate efficiently. A cooperative returns any excess of "income" over "outgo" to the producers who contributed the patronage upon which the excess was based. Dr. Joseph G. Knapp calls such excess "group savings," because it represents the aggregate savings accruing to individual members who have used the association (4, p. 52).

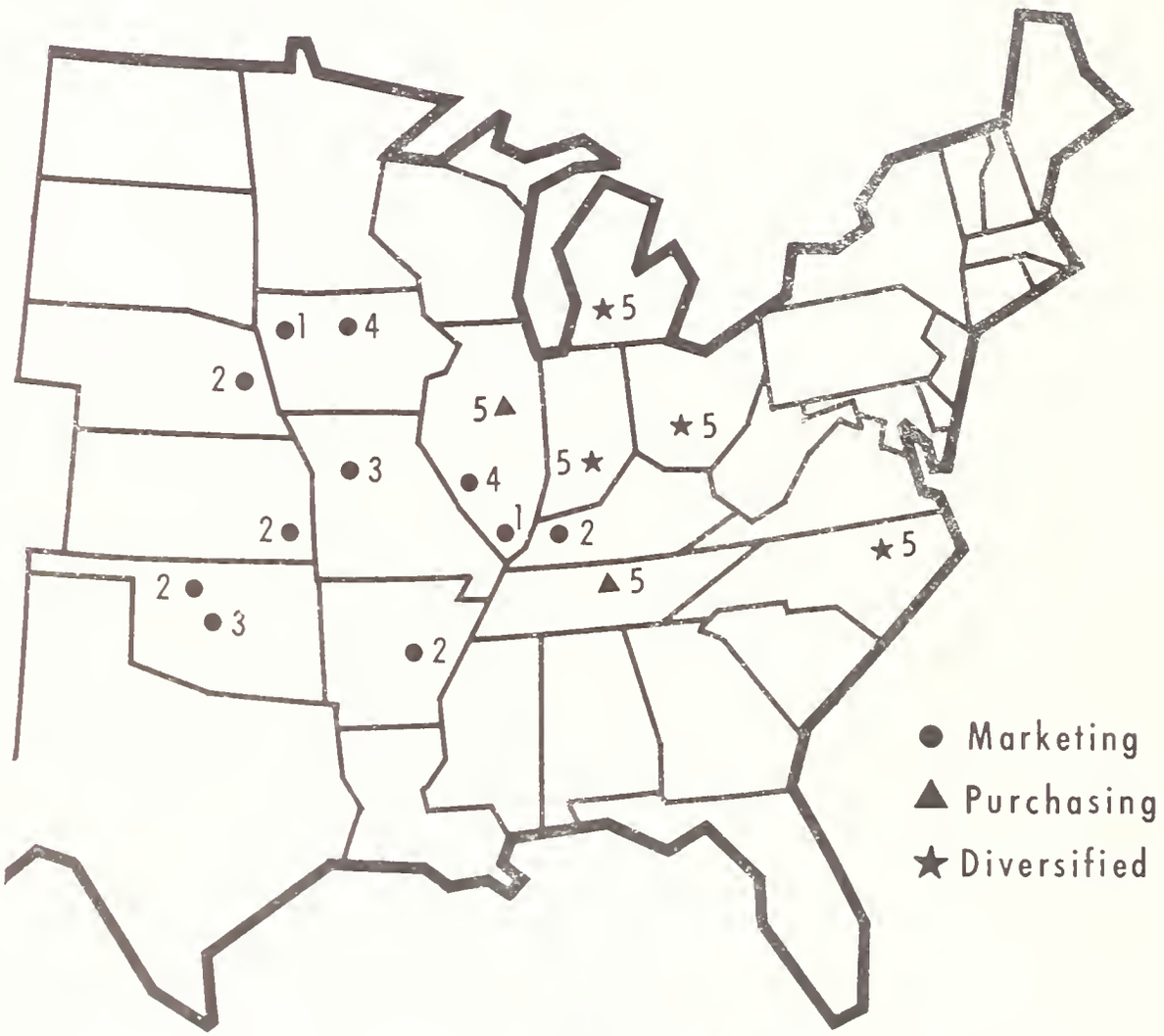
[2] Departmentalization is the division of operations for accounting purposes.

Providing services at cost is a fundamental principle of agricultural cooperation. Patronage refunds have long been the most practical way to return net savings to the farm.



The question is: Have patronage refunds kept pace and adapted to changing conditions in the agribusiness economy?

FIGURE 1. . . LOCATION OF COOPERATIVES PROVIDING DATA FOR THIS STUDY AND APPROXIMATE NUMBER OF PATRONS THEY SERVED, AUGUST 1965



NUMBER OF INDIVIDUAL PATRONS SERVED PER COOPERATIVE	Total	
	Patrons	Cooperatives
	Number	
I= Less than 1,000	1,300	2
II= 1,000-4,999	14,400	6
III= 5,000-9,999	13,300	2
V= 10,000-99,999	80,000	2
IV= 100,000 and over	916,000	6
TOTAL	1,025,000	18

Figure 1

In a discussion of patronage refunds, Kelsey Gardner states:

> If there is any one basic principle in cooperation, it is service at cost for member-patrons. From it arises the fundamental cooperative concept of savings as contrasted to profits in the usual business enterprise. Unfortunately, the belief of cooperators that net margins, allocated and distributed in accord with a legally-binding contractual obligation, are not income to the cooperative is not unanimously agreed to by some of these outside cooperatives (2, p. 6).

What many fail to realize is that the cooperative has no income, in the usual sense of the word, because those who own the organization are at the same time its members and patrons. All financial and other benefits are simply shared in proportion to each farmer's use of available services. Thus patronage refunds need to be studied to determine and explain their true economic nature, not only for members, but also for the public in general.

In the cooperative group venture, the producer theoretically can realize his savings in one of two ways. The first method is at point of contact with his association (time of purchase or delivery). This method is possible only if costs and expenses can be figured exactly beforehand, which is generally not feasible. The second way to realize savings--as is most often the case--is through patronage refunds reflecting the producer's use of his association over a period of time (usually on an annual basis; or sometimes quarterly or for other fixed periods) (7, p. 253). As stated in Legal Phases of Farmer Cooperatives (3, p. 220), patronage refunds "simply furnish a medium by which the undertaking of the association to operate on a cost basis, or as near thereto as possible, may be carried out."

Since we have seen that it is not generally possible to figure exactly cooperative costs and expenses at the outset of a transaction, we can readily see why cooperatives have over the years found it advisable to charge the going rate or price for services offered or goods bought or sold.

> Patronage refunds thus are a convenient means of reflecting to the members the cooperative's savings in direct proportion to each member's business. They are also a means of conveniently helping the member finance his cooperative.
>
> In other words, savings are not always paid in cash. They are often retained for capital purposes. Evidences of ownership are issued as certificates or other forms showing that the member has a certain amount of accumulated savings credited to his name (9, p. 7).

Tax Aspects of Patronage Refunds

The most recent legislation which expressly spells out the tax treatment of cooperatives and their patrons is contained in the Revenue Act of 1962. It is effective for taxable years beginning after December 31, 1962.

To be able to deduct patronage refunds from gross income in computing its Federal income tax liability, the farmer cooperative's patronage refunds must meet three strict requirements: (1) The refund must meet the definition of a "patronage dividend" as set forth in Subchapter T added to the Internal Revenue Code of 1954 by the Revenue Act of 1962 (see definition below). (2) The refund must be paid in cash, property, or "qualified written notices of allocation." (3) The refund must be paid within $8\frac{1}{2}$ months following the close of the cooperative's fiscal year (5, pp. 27-29).

Subchapter T defines a patronage dividend (refund) as the amount paid to a patron:

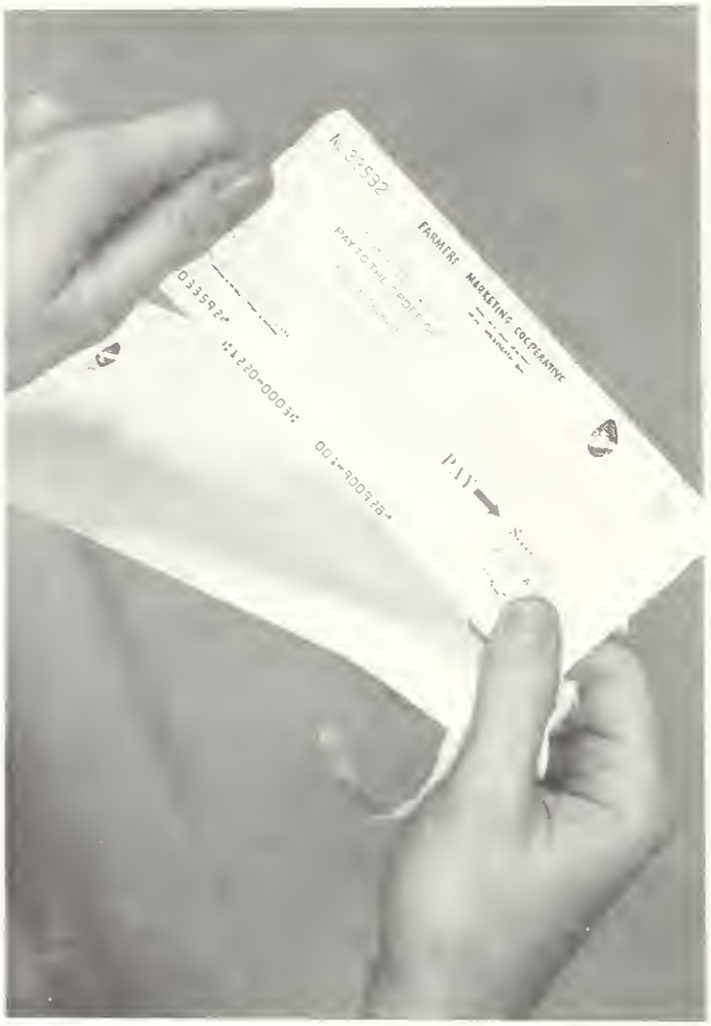
1. On the basis of quantity or value of business done with or for the patron.
2. Under an obligation which existed at the time the patron transacted his business with the organization.
3. As determined by reference to the net earnings of the organization from business done through or for patrons (5, p. 11).

The key differences between patronage refunds of a cooperative and dividends of a corporation may be summed up briefly. In a cooperative, patronage refunds are not left to the discretion of a board of directors. Bylaws and other legal documents usually obligate the cooperative to make patronage refunds and outline the steps to be followed in returning to patrons that part (or all) of the net savings on the basis of business transacted with the association.

In corporations other than cooperatives, stockholders have left to the board of directors power of controlling dividend policy. The board determines whether dividends on stock should be paid, as well as the nature and the amount of dividends. If declared, dividends are distributed to the stockholders in proportion to the number of shares held by them, and not on the basis of business transacted with the corporation. While patronage refunds are paid from current net savings, dividends on stock may be paid from accumulated earnings of more than 1 year.

A cooperative corporation returns net savings to patrons in proportion to the amount of business each transacts with it. The resulting refunds are expressed in a variety of ways--cents per bushel, cents per hundredweight, cents per pound, dollars per ton, percentage of sales, and so on--depending upon the activities engaged in by the cooperative.

As used in this report, the term "patronage refunds (or patronage dividends)" refers to amounts allocated to patrons based on their volume of business with the cooperative. These allocations, made at the end of a fiscal year or other fixed period, represent net amounts remaining after meeting all operating overhead and maintenance costs and expenses. Such refunds are made in (1) cash or (2) noncash forms, such as capital stock, revolving fund certificates, letters of advice, and the like, or both ways. They are also made by crediting patrons' equity accounts without giving written notices of such allocations.



Some cooperatives pay refunds at final settlement; others consider all payments to patrons (advances and final settlement) as patronage refunds.

Pooling and Elements of Patronage Refunds

To this point the definition of patronage refunds seems quite clear. Occasionally, however, the issue becomes a little cloudy, when there is pooling. Officials of two large marketing cooperatives reported that their associations operated on a pooling basis and, therefore, made no patronage refunds. These officials did not consider that their associations were participating in any form of patronage refund plan for the following reasons: (1) The associations acquired capital by making per unit capital retains instead of relying on

retention of net savings, and (2) the associations did not make per unit deductions to cover costs of handling or grading products, or to meet other operating expenses.

Pooling, per se, however, does not preclude the payment of patronage refunds. For example, one marketing cooperative studied operated a pool--running simultaneously with its fiscal year, which ends March 31--and also made patronage refunds. The organization did not "buy" any products from its members. Products were consigned to the association and then graded and sold on a pooled basis. When the grower shipped his product to the association, he authorized the association to deduct ½ cent a pound as a capital retain from his advance payment, and a per unit hauling and grading charge that varied with the size of his shipment.

During the operation of the pool, more than $1 million was advanced to growers. The amount advanced was determined by reference to the market price of the products sold and the expected price of the unsold products. At the close of the pool, the cooperative refunded net savings of $20,000 to growers on a patronage basis. The following tabulation indicates how the patronage refunds were determined:

Pool Operating Statement for Year Ended March 31, 1965

Sales		$1,500,000
Value of products marketed:		
Beginning inventory	$77,000	
Advances (or payments) to growers [1]	1,400,000	
Products available for sale	1,477,000	
Less ending inventory	47,000	
Value of products marketed		1,430,000
Gross savings on sales		70,000
Other operating revenue:		
Per-unit handling charges	100,000	
Per-unit grading charges	50,000	
		150,000
Gross savings on operations		$220,000
Operating expenses		200,000
Net savings		20,000

[1] Includes per unit capital retain certificates issued to growers by the cooperative.

The tabulation shows that pooling cooperatives making per unit capital retains may also make patronage refunds.[3] In the case illustrated, the refunds resulted largely from unused per unit operating retains. What then of the two associations that operated pools and had no patronage refunds? These two associations said that they strictly limited per unit deductions to capital retains. Both made an advance (or advances) to patrons upon receipt of product. At the close of their pools, each cooperative determined the excess of receipts over the sum of expenses and previous advances to patrons, and made a final payment or settlement to producers.

The question here is: Under what circumstances is a final settlement made by a pooling cooperative not a patronage refund? We must conclude tentatively that it is not a patronage refund if the final settlement did, in fact, serve to bring the farmer's payment up to or near the estimated "going rate or price for products delivered."

Some pooling cooperatives regard all payments (advances and final settlement) made to the patron as a patronage refund. This concept has merit in associations that pool sales proceeds. Such pooling of sales proceeds is a natural consequence when cooperatives guarantee a market for all products shipped by patrons. To provide such a market, the association usually sells some products at a much lower value than others (for example, in processed form rather than fresh).

Since sales proceeds under such a marketing program represent a blended or pooled price to patrons, the market price for raw products at time of delivery, in many instances, is indeterminate. Therefore, total payments to patrons may be considered patronage payments or refunds after deducting all expenses connected with marketing and with processing the raw products.

However, if the initial advance or advances reflected the current market value and the final settlement returned savings realized from efficient operations above current

[3] For a discussion of the essential features and tax treatment of capital retains, see Per-Unit Capital Retains (6).

market value, such final settlement would be a patronage refund as here defined. At times the final settlement may contain elements of both capital retains (as evidenced by per unit retain certificates, fixed without reference to net earnings) and patronage refunds.

For these two pooling cooperatives, did the advances made during their operation and prior to their final payment represent the estimated or actual market price? According to the bylaws of one, title passed to that cooperative upon receipt of product. Thus the advance appears to be the same as the price paid to the producer for the product. Therefore, any final settlement after operating expenses and advances have been deducted, seems to qualify as a patronage refund. Information obtained about the final settlement of the second pooling cooperative was not sufficient for estimating whether it represented savings over and above the market value of the products delivered.

For cooperatives that pool sales proceeds, we have two concepts of patronage refunds: (1) Where the market value of raw products can be determined, the final settlement is the patronage refund, if it returns savings realized from efficient operations above the current market value; and (2) where the market value of raw products is indeterminate, total payments received by patrons for products marketed may be considered as the patronage refund.

However, before we consider the problems encountered among the 18 associations, let us first discuss the fundamental factors immediately prerequisite to the computation of patronage refunds.

FUNDAMENTAL FACTORS CONSIDERED

In a study of patronage refunds, the association's written instruments prescribing distribution of savings become an important source of information. Not only do these written agreements show the cooperative's commitment regarding refunds; but they also, in most cases, set forth other deductions from net savings which affect the amount available for patronage refunds.

Officials of the 18 associations were asked, Was allocation or distribution of patronage refunds provided for in a written obligation contained in your cooperative's organization papers? Fifteen replied that it was. Of the three cooperatives having no such written obligation, one was undergoing a corporate reorganization. The other two were marketing products on a pooling basis, as we have discussed, and considered patronage refunds irrelevant to their type of operations.

Where does such a written obligation usually appear? All 15 cooperatives indicated that it is included in their bylaws. (One association signified its membership agreement also mentioned refunds.) Typical examples of the way the bylaws were worded regarding refunds are as follows:

> Example 1. In order to induce patronage and to assure that this cooperative operates on a nonprofit basis for its members, the association is obligated to account for its net savings to all members on a patronage basis. At the end of each fiscal year, net savings shall be apportioned and refunded to member patrons in cash, revolving fund certificates, or by credits to their accounts in the capital ledger. That part of net savings derived from business with nonmember patrons shall be retained by the association as unallocated surplus. If the cooperative suffers a net loss in any year, such loss shall first be charged against unallocated surplus until it is exhausted, and then against the capital ledger accounts.
>
> Example 2. This association shall be operated on a nonprofit cooperative basis for the mutual benefit of its members and patrons, and all net savings or margins, not needed for payment of dividends on

capital stock, or repairment of a loss, shall be distributed each year as patronage refunds. Such refunds shall be made in cash, certificates of ownership, capital stock or by crediting patrons' accounts; and shall be at all times the property of the patrons and not the property or savings of this cooperative.

The question was asked, "Did your association show an overall net savings for your last fiscal year?" Fourteen of the 16 associations paying refunds reported that they had a net savings. Table 2 shows total net savings realized by the 14 cooperatives and deductions made before arriving at the amount paid to patrons on a patronage basis. Altogether, three-fourths of their net savings were distributed as patronage refunds. About 70 percent were paid in cash and 30 percent in noncash forms, such as capital stock and revolving fund certificates. Ways of distributing refunds are covered in greater detail in the section "Procedures Used in Distributing Refunds."

Table 2.--Disposition of net savings made by 14 cooperatives for fiscal years ending in 1964 and 1965

Item	Dollars	Percent
Total net margins or savings	17,594,952	100.0
Less: Dividends paid on capital stock	2,471,505	14.1
Unallocated retained savings	1,089,301	6.1
Federal and State income taxes	826,825	4.7
Total deductions	4,387,631	24.9
Total amount paid to patrons on a patronage basis	13,207,321	75.1

The other fourth of the net savings was accounted for in three ways. Fifty-six percent was paid as dividends on capital stock. Often this was capital stock that had been issued as patronage refunds in prior years. Unallocated retained savings or "free surplus" accounted for 24 percent. Income taxes took the other 20 percent. The third deduction, for income taxes, resulted almost entirely from the other two. The net savings realized were not vested in members or in all patrons either currently or upon dissolution but were distributed as dividends on capital stock or retained as free or unallocated surplus. Thus they are taxable at the cooperative level.[4] The only patronage refunds which are taxable, as pointed out on page 5, are those not qualifying under existing legislation. Only one association reported nonqualifying patronage refunds and paid income tax on this amount.

Some may ask, "Why do cooperatives retain any unallocated savings, if they operate at cost?" Several reasons account for this: (1) Cooperatives may follow the policy of paying patronage refunds to members only, with savings resulting from nonmember business retained in the cooperative for capital purposes. (2) Small refunds--for example, less than $1--may not be returned to patrons because of the high cost of making such refunds in relation to their value. (3) Some State laws may require cooperatives to maintain reserves of a certain amount as additional security to creditors, and some cooperatives have construed this to mean unallocated reserves. (4) Sometimes a cooperative may allow itself to drift away from the operation-at-cost principle.

Referring to this latter situation, Gardner stated:

> The extent to which patronage refund amounts may be diverted to so called free surplus or to higher returns on capital reduces the amount of financial benefits to be shared in proportion to the use of an association's services. To direct funds

[4] Net savings distributed as dividends on capital stock were not taxable to 5 of the associations because of their qualification under Section 521 of the Internal Revenue Code. This point is discussed further on p. 20 of this report.

in this manner would conflict directly with the cooperative concept because its effect would be to bolster the investment aspects of an association by increasing their significance from the standpoint of rates of returns (2, p. 11).

The 14 associations used 6 different combinations of methods to distribute their net savings during fiscal 1964-65. Table 3 illustrates the combinations of methods and percentages involved.

Two of the cooperatives had not distributed any net savings as patronage refunds since 1959. Two had a policy of distributing all net savings as patronage refunds. Two others (nonstock cooperatives) distributed all member savings as patronage refunds, but retained nonmember savings as unallocated surplus on which income tax was paid.

One association distributed all net savings (after income tax) as patronage refunds. It paid refunds by crediting patrons' equity accounts without giving written notices of such allocations. This method of paying refunds does not meet the "qualified written notice of allocation" requirement contained in Subchapter T of the Revenue Act of 1962. Thus, its refunds were not qualified and had to be taken into account in figuring taxable income.[5]

Another cooperative distributed all net savings as patronage refunds after paying dividends on capital stock. The income tax resulted from a small amount of refunds, placed in contingency reserve, on which patrons received no written notification. In six others, as shown in table 3, patronage refunds were paid after making the other types of distributions.

Table 3.--Combination of methods used in distributing net savings by 14 cooperatives during fiscal year 1964-65

Number of cooperatives	Type of distribution				Total net savings
	Patronage refund	Capital stock dividend	Unallocated retained saving	Federal and State income taxes	
	Percent				
6	78	12	5	5	100
2	92	0	6	2	100
2	100	0	0	0	100
2	0	50	31	19	100
1	81	0	0	19	100
1	73	25	0	1	100

METHODS USED IN COMPUTING PATRONAGE REFUNDS

Determining net savings of each individual transaction would be highly impractical for most farmer cooperatives because of the size and complexity of their operations. For this reason, many cooperatives figure a rate of refund by dividing savings to be distributed as patronage refunds by the total volume of patronage--measured, generally, in either physical units (bushels, tons, pounds, etc.) or dollars. This rate is then used as the factor in determining the amount of each patron's refund. As long as all transactions between cooperative and patrons result in approximately similar savings, this method is an equitable one.

[5] The meaning of qualified and nonqualified patronage refunds is discussed on p. 18 of this report.

However, as cooperatives expand their operations--for example, when a farm supply cooperative adds marketing facilities, or vice versa, or when a dairy bargaining cooperative diversifies its activities to include egg marketing--the equitability of patronage refund distribution methods is usually improved by using accounting procedures that enable the cooperative to determine net savings on a divisional, departmental, or product basis. By using such procedures, net savings or net losses are obtained from as nearly homogeneous a group of products as is practicable and reasonable from a business standpoint. Separate refund rates are then computed for distributing net savings from each operational unit to patrons on a patronage basis.

Information obtained from officials of 16 cooperatives revealed that all had subdivided their operations to some extent.[6] Twelve of the 16 cooperatives operated both marketing and farm supply divisions; the other 4 operated departments strictly within either marketing or farm supplies.

In this study we grouped methods of computing patronage refunds into four major classifications: (1) On a total business basis; (2) on a divisional basis; (3) on a departmental basis; and (4) a combination of methods.

On a Total Business Basis

When patronage refunds are computed on a total business basis, one rate of refund is computed for net savings, regardless of types of products handled or the number of departments or divisions within the association. This rate is determined by dividing the net savings to be distributed by the total dollar volume of business. If refunds are distributed to members only, the volume of member business is used as the basis for computing refunds. However, if refunds are distributed to members and nonmembers, then total business volume is the basis.

The obvious advantages of the total business method of computing patronage refunds are the simplicity with which such refunds can be determined, the relatively small amount of bookkeeping necessary, and the minimizing of the problem of how to handle losses between divisions or departments.

On the other hand, the total business method has obvious deficiencies. Unless patrons of both marketing and farm supply divisions are virtually the same, one rate of refund may reflect an inequitable distribution of savings. In general, refund rates would seem more representative, and thus more equitable, when closely related to a product or a homogeneous group of products than to dissimilar items that may produce margins of greater variability.

Four of the 16 cooperatives computed patronage refunds on the total business basis. These four--dealing primarily in dairy, grain, livestock, and wool--were all chiefly marketing associations. Although they figured the refunds on the total business basis, all had divided their operations to some extent.

Cooperative A. Cooperative A operated two divisions: one in wool marketing, the other a small supply division. Savings from each of these divisions were combined into one fund. To compute the patronage refunds, this total was divided by the total pounds of grease wool shipped by all patrons. The result was a per pound rate of refund. The association reasoned that the added expense of computing refunds by divisions was unnecessary in its case because the supply sales were relatively small and the patrons of both divisions were substantially the same.

Cooperative B. When this association computed patronage refunds, its savings came from cattle, hog, and sheep departments and were combined in one fund. The association then divided this fund by the total commissions paid by all patrons, resulting in a single rate of refund per $1 of commissions (or marketing charges collected).

Cooperative C. Cooperative C had two divisions, with five departments in its marketing division. . .butter, condensed milk, dry milk powder, and whole milk and cream. In the supply division, there was no departmentalization because of product similarity and relatively small turnover in inventory. This association used departmentalization in its

[6] As mentioned on p. 6, 2 cooperatives interviewed for the study did not regard patronage refunds as applicable to their type of pooling operation.

As our Nation's cooperatives expand and diversify operations, computation and distribution of patronage refunds become more of a problem. Regionals compute refund rates either on a total business, divisional, or departmental basis, or use a combination of these methods.

Generally, refund rates seem more equitable when closely related to a product or homogeneous grouping of products. Many regional cooperatives obtain equitability by computing patronage refunds on a departmental basis.

marketing division as a management tool to determine efficiency of operation, but did not use it in computing refunds. The association computed only one rate of refund in determining the amount of patronage refund to be returned to each patron. This rate was based on the pounds of raw whole milk (both Grade A and manufacturing grade) marketed by the association for its patrons, as follows:

$$\frac{\text{Net savings}}{\text{Total lbs. of raw whole milk marketed by cooperative}} = \frac{\$215,700}{369,468,725} = 5.838112 \text{ cents per cwt. rate of refund}$$

Cooperative D. This association maintained separate accounting for its farmer members (Class A) and its cooperative association members (Class B). Savings to be distributed from the marketing and retail supply business with Class A patrons were placed in one fund. The association then divided this amount by their total dollars of purchases and sales in computing the cents-per-dollar rate of refund. Likewise, savings from the wholesale business with Class B patrons were not distributed on a departmental basis but were combined into one fund. This was then divided by their total volume of business to determine the cents-per-dollar refund rate to be used in distributing these savings to Class B members.

The use of different rates of refund for different classes of members, as illustrated by Cooperative D, occurs not only in those associations using the total business method to compute refunds, but also in those using the divisional and departmental methods. Such a procedure improves the equitability of refund distributions when these different rates reflect actual differences in costs of services.

On a Divisional Basis

A division is a separation of operations by major functions such as marketing or farm supply. Two or more rates of refund are computed depending upon the number of divisions within the cooperative.

Three of the 16 cooperatives figured their patronage refunds on a divisional basis. Cooperative "G" was mainly a farm supply association but also had a marketing division. Cooperative "E" was mainly a marketing (cottonseed) cooperative, with minor farm supply. The other association--Cooperative "F"--was about equally divided between marketing and farm supply operations.

Cooperatives E and F. In computing patronage refunds, Cooperatives E and F used essentially the same method of figuring one refund rate for each division based on its net savings and patronage. For example, in Cooperative E, patronage refunds came from two sources: Savings from handling farm supplies and commissions from tobacco marketing. Total patronage refunds in 1965 amounted to $15,000 and were paid in cash. Farm supply savings counted for $9,000, and unused (or net) commissions from the sale of tobacco made up the balance.

The cooperative used one refund rate (5 percent of sales) to distribute the $9,000 of farm supply savings. Likewise, in returning to patrons the $6,000 saving from marketing, it used one rate of refund (25 percent of the selling charges on tobacco). As indicated by the single refund rate in each division, no further departmentalization of accounting was used in computing patronage refunds. The only product marketed was tobacco; and because of the relatively small supply sales, management considered it unnecessary to extend departmentalization to the product level.

The question members need to realize in determining patronage refund policy in this instance is: Assuming greater equity could be obtained by determining net savings by products, would it be worth the additional expense of maintaining more detailed records?

Cooperative G. Cooperative G was primarily engaged in handling farm supplies with 90 percent of its 1964-65 business in this area. Its departmentalization extended to the product or commodity level in the supply division, with a manager in charge of each of the six departments--feed, fertilizer, petroleum, hardware, seed, and agricultural chemicals. In the marketing division there was no departmentalization. Notwithstanding

When a single commodity is marketed, such as the livestock shown above, and returns from farm supply sales are small, management will often use the total business method of returning net savings to farmers. The expense of more departmentalized record-keeping could well outweigh any improvement in equity.

the departmentalization of its farm supply division, management used the two functional divisions as bases for computing patronage refunds. According to management officials interviewed, net savings were figured for each of the six farm supply departments by allocating overhead costs on a sales basis. This was done to provide directors with a measurement of the performance of each of the departments. In the judgment of management, the association would have to install an expensive cost accounting system to be able to prorate true overhead costs to each of these departments. Without such a system, the association's management believed it would not achieve greater equitability by figuring separate patronage refunds for each of the six departments.

On a Departmental Basis

A department is the separation of operations within a division. For example, the farm supply division may have such departments as fertilizer, mixed feed, and petroleum. When refunds are figured on a departmental basis, a cooperative may compute one rate of refund for each of the departments within a division and the refunds are then made to the patrons of the respective departments. Each rate is arrived at by dividing the net savings of the department by the total business volume of that department. If refunds are paid only to members, however, nonmember business volume is excluded when computing the refund rate.

There is further breakdown possible within a department. For example, in a single grain department, there may be as many sections as there are types of grain marketed--wheat, oats, corn, barley, etc. When such sections exist, patronage refunds may be figured on an intradepartmental basis by (a) computing separate rates of refund for each type of product, or (b) grouping similar products together

and making one rate of refund. Thus a cooperative may compute the rate of refund on the basis of net savings resulting from either (a) or (b). As in the other methods, if refunds are paid only to members, nonmember business is excluded from total business volumes used in computation.

Of the 16 associations, 6 computed their patronage refunds on the departmental basis. This was the most widely used method among the cooperatives interviewed. Three of these associations were primarily marketing; two had large business volumes in both marketing and farm supply; and one handled only farm supplies. Commodities handled included dairy products, eggs, soybeans, small grains, and all types of farm supplies.

Cooperative H. Cooperative H maintained seven departments, organized within three major divisions as follows:

Division	Department
1. Marketing	1. Wholesale (grain and beans)
	2. Retail (grain and beans)
	3. Egg
2. Manufacturing	4. Plant food
	5. Feed
3. Farm supply sales	6. Wholesale
	7. Retail

The cooperative determined the net results of each department's operations and then used the resulting net savings or losses as the basis for computing patronage refunds. Table 4 illustrates this procedure and shows how departmental losses were absorbed by other departments with savings. The method used in determining the amount of loss to be absorbed by each department with savings was to multiply the total loss ($12,000) by that department's percentage of total savings.

For example, in table 4 the first department listed (wholesale farm supplies) accounted for 28 percent of total net savings distributed as patronage refunds. Therefore, it was charged with 28 percent ($3,360) of the total loss which resulted in a $80,640 patronage refund paid to patrons of this department. Obviously no patronage refunds were paid by the two net loss departments. The manager commented that members were completely satisfied with this method of computing patronage refunds. It incorporates the essential factors that provide for equity in a diversified cooperative: (1) Grouping of similar products or functions by departments; and (2) using the net results of these departments as the bases for computing refunds.

Cooperative I. This marketing cooperative processed and marketed soybeans, operated an egg marketing department, and sold mixed

Table 4.--Computing patronage refunds by departments, for year ended August 31, 1965

Department	Net savings [1]		Net losses		Patronage refunds
	Amount	Percentage of total	Amount	Distribution	
	Dol.	Pct.	Dol.	Dol.	Dol.
Wholesale farm supplies	84,000	28.0	0	(3,360)	80,640
Retail farm supplies	106,000	35.3	0	(4,236)	101,764
Plant food manufacturing	55,000	18.3	0	(2,196)	52,804
Feed manufacturing	20,000	6.7	0	(804)	19,196
Egg marketing	0	0	(7,400)	7,400	0
Retail marketing	0	0	(4,600)	4,600	0
Wholesale marketing	35,000	11.7	0	(1,404)	33,596
Total	300,000	100.0	12,000	0	288,000

[1] After dividends on capital stock, Federal income taxes, and unallocated retained savings.

feeds and seeds. It maintained separate accounting for its six departments: Soybeans purchased; soybean meal; feed ingredients; mixed feed sales; seed; and eggs. It computed separate rates of refund for each of these departments, except eggs. The cooperative's policy was to pay patronage refunds to members only; because patrons selling to the egg department were nonmembers, the cooperative did not pay patronage refunds to these patrons. In the feed ingredients, mixed feed sales, and seed departments, it transacted business with other regional cooperatives as well as with member locals. Separate accounting was maintained for the business transacted with the locals and regionals in these departments. Separate rates of refund were computed for distribution to local cooperatives based on the savings resulting from local transactions. Separate rates of refund were also computed and paid to regional associations based on the savings resulting from regional transactions.

Cooperative J. Cooperative J was a large-scale farm supply cooperative maintaining 3 departments--petroleum, feed, and plant food--sectionized into 24 products or product groupings. Within each of these three departments, net savings were determined by sections composed of (1) a single kind of product (for example, paint) or (2) a group of similar products (for example, livestock equipment). As table 5 indicates, of the 24 sections within the 3 departments, 22 paid patronage refunds. The other two--protein ingredients and potash--incurred net losses and paid no refunds. We did not determine how the association handled these losses in computing patronage refunds. This large regional had a net savings of nearly $8,000,000 in 1965. Seventy-five percent of this amount--$5,950,000--was returned to its member farmer cocperatives as patronage refunds. Table 5 illustrates the elaborate system of departmentalization maintained by this association and how it related directly to the computation of patronage refunds.

Cooperatives K, L, and M. Cooperatives K, L, and M computed and distributed patronage refunds on a departmental basis. Their methods did not differ in any appreciable way from those explained for Cooperatives H, I, and J.

Combination of Methods

An association with two or more divisions may compute its refund rate on a divisional basis for marketing, but use a departmental basis for its farm supplies. Or, an association with both marketing and farm supply divisions may compute its patronage refunds on a departmental basis, but use a total business basis for distributing its nonpatronage income as patronage refunds. Cooperatives N, O, and P used various combinations of methods to compute patronage refunds.

Cooperative N. Cooperative N, an association with both marketing and farm supply divisions, allocated net savings within the farm supply division to each product department on the basis of gross margins of each of the products. It computed rates of refund for each of the products showing a savings. We did not determine how it handled losses. In the marketing division, however, it computed only one rate of refund. This was on the basis of a physical unit, usually bushels.

According to the manager of Cooperative N, this combination of methods used in computing patronage refunds was the most equitable and practicable policy for his association because products marketed produced similar gross margins. In the farm supply division, however, the great variety of products handled necessitated greater departmentalization because of the wide range of gross margins established for the various products handled.

Cooperatives O and P. Cooperatives O and P based patronage refunds on a departmental system, with one notable exception. Departmental lines were not observed necessarily in distributing nonpatronage income. Cooperative O, for example, derived nearly 60 percent of its 1964 patronage refund, $500,000, from incidental income or nonoperational sources not directly related to the association's marketing or purchasing activities. This "nonpatronage income" came from the sale of stock investments and liquidation of a subsidiary. It was allocated to patrons of the years during which these investments were

Table 5.--Departmentalization based on a product or grouping of similar products to obtain equitability in computing patronage refunds for year ended June 30, 1965

Section	Business volume on which a patronage refund was based		Rate of refund [1]	Total patronage refunds
	1,000 dollars	1,000 gallons or tons	Dollars	1,000 dollars
Gasoline	--	160,370G	0.00935	1,500
Burner fuels & dieselex	--	94,100G	.01010	950
L P Gas	--	15,300G	.00523	80
Lubricants	1,550	--	.10322	160
TBA	1,480	--	.06486	96
Paint	860	--	.10698	92
Appliances	24	--	.08333	2
Total petroleum department	--	--	--	2,880
Mixed feed	--	186T	6.02	1,120
Complete swine feeds	--	10T	1.00	10
Protein ingredients	--	--	--	0
Animal health	427	--	.05621	24
Specialty products	538	--	.06691	36
Livestock equipment	1,854	--	.06742	125
Steel products	1,490	--	.03020	45
Total feed department	--	--	--	1,360
Mixed fertilizer	--	110T	3.45	379
Anhydrous	--	70T	6.60	462
Aqua	--	30T	2.17	65
Ammonium nitrate	--	84T	3.62	304
Solution 41, other solutions and 30-10-0	--	65T	.49231	32
Phosphates	--	150T	1.00	150
Rock phosphate	--	120T	.10000	12
Farm chemicals	4,030	--	.07444	300
Seed	385	--	.01558	6
Potash	--	--	--	0
Total plant food department	--	--	--	1,710
Total patronage refunds	--	--	--	5,950

[1] Computed by dividing each section's patronage refund dollars (net savings of section after deductions for capital stock dividends, income taxes and unallocated retained savings) by its volume of business measured in dollars, gallons, or tons.

held. Farmer cooperatives, such as this one, that qualify under Section 521 of the Internal Revenue Code, may, in addition to other deductions permitted by the Code, deduct income from nonpatronage sources provided the amounts in question are handled in accordance with Subchapter T.

Equitability in the computation of such refunds is required since Income Tax Regulations prescribe that:

> In order that the deduction for amounts paid with respect to income derived from business done with or for the United States or any of its agencies or from sources

other than patronage may be applicable, it is necessary that the amount sought to be deducted be allocated on a patronage basis in proportion, insofar as is practicable [7], to the amount of business done by or for patrons during the period to which such income is attributable (1, p. 36,683).

PROCEDURES USED IN DISTRIBUTING REFUNDS

Not only do cooperatives use different methods in computing patronage refunds; but they also follow different procedures in distributing these refunds. Cooperatives generally distribute patronage refunds in the form of cash, written notices of allocation, or book credits without written notification to patrons. Table 6 indicates the different types of distribution used by 12 of the 18 cooperatives in paying refunds.[8]

Table 6.--Media used by 12 cooperatives in paying patronage refunds for their last fiscal year ending in either 1964 or 1965

Media	Total refund	Percentage of total
	1,000 dollars	Percent
Cash	9,506	72.0
Qualified written notices of allocation:		
Common stock	1,648	12.5
Preferred stock	1,190	9.0
Letters of advice	458	3.5
Certificates of various kinds.	380	2.9
Book credits without written notice of allocation to patrons.	25	.1
Total patronage refunds	13,207	100.0

As indicated in table 6, the cooperatives paid out as cash slightly more than 70 percent of all patronage refunds. Such cash refunds were not taxable to the cooperatives but were taxable to patrons for the year in which they received them. The cooperatives retained about 30 percent of the refunds for capital.

Table 6 further shows that all (except for one-tenth of 1 percent) of the noncash refunds were qualified written notices of allocation. Just what are "written notices of allocation" and what does "qualified" imply?

1. Written notices of allocation are any capital stock, revolving fund certificates, certificates of indebtedness, or other written notices, which disclose to the patron the stated dollar amount allocated to him by the cooperative as a patronage refund.

2. For a written notice of allocation to be qualified, and therefore not taxable to the cooperative, 20 percent or more of the patronage refund must have been paid in cash with the patron consenting to include the noncash portion of the patronage refund in his gross income for the year in which he received such noncash refund.

Common and preferred stock accounted for about three-fourths of the value of noncash refunds. Letters of advice, and certificates of various kinds, made up the balance. Two associations made patronage refunds in the form of book credits without written notice of allocation to patrons. In referring to book credits, one of the cooperatives used the term "Patrons' reserve" in the net worth section of its balance sheet. Only about 1 percent of its 1964 patronage refund was allocated as book credits which would not be revolved to patrons in cash, until the reserve is liquidated at some future date or the association dissolves. The reason for allocating this reserve on a patronage basis instead of retaining it as a free (or unallocated) reserve was to insure equitability in any future distribution of this amount.

[7] Many authorities consider the phrase "insofar as is practicable" of vital importance. A tax analyst, associated with one of the large regional cooperatives included in this study, gives the following example: "Technically any gain realized on the sale of a truck held for 4 years would belong to the patrons of those 4 years. However, the current thinking is that allocating a small amount of income (say $200) to patrons of 4 years would not be practical. Therefore, the $200 can be treated as part of the net savings for the current years and allocated to the patrons of that year."

[8] Table 6 is based upon information received from 12 cooperatives, since the remaining 6 cooperatives studied either (1) did not recognize patronage refunds in their type of operations, (2) incurred net losses for the period studied, or (3) did not distribute patronage refunds during the period in question.

The other association distributed all of its 1965 net savings (less income tax) in the form of book credits without written notices of allocation to patrons, as shown in the following tabulation:

Total net savings for year ending, March 31, 1965	$ 20,746
Less: Federal income tax	3,957
Total patronage refunds in form of book credits without written notice of allocation to patrons	16,789

We asked the association's manager why this cooperative did not qualify its refunds. He was positive in his belief that many of the patrons would not consent to include in their income the noncash portion of a patronage refund. He believed that if refunds were qualified the number of patrons marketing through this association would substantially decrease.

Noncash Refunds and Patron Consent

Procedures used by 12 cooperatives in getting patrons' consent to include the noncash portion of patronage refunds in their tax returns are shown in the following tabulation:

Procedure	Number of cooperatives
Bylaw consent [1]	11
Individual patron's written consent	3
Consent by qualified check [2]	3

[1] Cooperative has a bylaw which provides that membership constitutes consent.

[2] Patron endorses and cashes, on or before a specified date, a check which has imprinted on it that such action constitutes consent, which represents at least 20 percent of total refund.

Cooperatives not reporting use of these procedures to get patrons' consent were the 2 pooling associations, the 3 cooperatives that paid all patronage refunds strictly in cash, and the 1 association making all patronage refunds as book credits. Many of the cooperatives studied followed more than 1 procedure. Thus the total number of cooperatives in the tabulation exceeds 12 because 4 cooperatives listed more than 1 procedure. Bylaw consent, of course, can be used only for members. For nonmember patrons, the cooperatives used either individual written consent, consent by qualified check, or both.

The tabulation shows that 11 of the 12 associations used bylaw consent. Usually, the cooperative's bylaw was worded somewhat as follows:

> Each person who hereafter applies for and is accepted to membership in this cooperative, and each member of this cooperative on the effective date of this bylaw, who continues as a member after such date shall, by such act alone, consent that the amount of any distributions with respect to his patronage. . .which are made in written notices of allocation and which are received by him from the cooperative, will be taken into account by him at their stated dollar amounts. . .in the taxable year in which such written notices of allocation are received by him.

The one cooperative that did not use bylaw consent depended upon consent by qualified check for both member and nonmember patrons. One large regional used all three consent procedures. For nonmembers, one procedure was to obtain individual written consent at the time of the transaction. If this was not possible, consent by qualified check was used at the time of the refund. By using all three methods, this regional obtained 100 percent agreement from patrons for the last 2 years, 1964 and 1965.

Treatment of Small Refunds

Regarding the treatment of patronage refunds under a certain size, the question was asked, "Are small refunds paid or allocated to patrons if less than a certain amount?" Nine cooperatives replied yes; seven, no.

Of those saying no, all had adopted a policy of paying no refunds to patrons if the amount was less than $1. In one case, however, if the patron was a nonmember eligible for membership, the less-than-$1 refund was placed in a

"stock trust account" to be applied to the purchase of one share of $1 par value common stock whereby the patron automatically became a member patron. Management officials of three associations interviewed indicated that special treatment was given to refunds of less than $5. One cooperative paid refunds falling in this size category entirely in cash. The other two associations made these refunds solely in written notices of allocation.

Section 521 Cooperatives

Of the 16 cooperatives operating on a patronage refund basis, 9 met requirements set forth in Section 521 of the Internal Revenue Code. They held "letters of exemption" from the Commissioner of Internal Revenue. One requirement for cooperatives qualified under Section 521 is that members and nonmembers be treated in the same manner in regard to patronage refunds. However, there was uncertainty among some association officials interviewed as to the exact meaning of this requirement. Some wondered what is meant by treatment ". . .in the same manner." One cooperative interpreted this requirement to mean that "all patrons receive the same rate of refund within each commodity department."

Section 521, as amended, permits exceptions to the identical treatment of patrons in the following situations:

1. No cash has to be paid as patronage refunds to patrons who do not consent to include noncash refunds in their own tax returns.
2. Refunds between $1 and $5 may be paid solely in written notices of allocation.
3. Refunds of less than $1 need not be paid at all. The cooperative pays taxes on these amounts so retained.
4. Smaller amounts of dividends or interest may be paid on nonqualified allocations to nonconsenters than is paid on qualified allocations to consenters.

Seven associations did not meet Section 521 requirements. These cooperatives followed a policy of making patronage refunds only to members. They did not maintain patronage records for nonmember business. In such cooperatives, members benefit from savings resulting from transactions with nonmembers. The unallocated reserves also absorb losses from this type of business when they occur.

In computing taxable income, both types of associations--those which qualify under Section 521 and those which do not--may exclude qualified patronage refunds from gross income. Major differences are: (1) Cooperatives qualifying under Section 521 may deduct dividends paid on capital stock. Other cooperatives may not deduct these dividends. (2) Cooperatives qualifying under Section 521 may deduct nonpatronage income allocated to patrons; other cooperatives may not.

PROBLEMS ENCOUNTERED

Cooperative management officials were asked to list problems. Most of the problems reported related either directly or indirectly to matters of equitability. Problems ranged from handling divisional and departmental losses to recording and distributing small refunds. Among these 18 regionals we found misunderstanding resulting from a lack of generally accepted definitions of such terms as "nonpatronage income," "patronage refund," "final settlement," and "net savings."

Treatment of divisional and departmental losses were listed by five associations as areas needing further research if cooperatives are to develop the most effective patronage refund policies. Some of the decisions facing these associations were: How do we treat a loss in our marketing division when the purchasing division operated at a margin? Should margins from farm supply absorb marketing losses? Is such action equitable if patrons of both divisions are virtually the same? If they

are not? Is it more equitable to incorporate separately the various divisions of a cooperative?

In a similar vein, questions of equity arise when the loss of one department is charged against the earnings of another department within the same division. Does this unfairly subsidize the operations of certain patrons? Should the loss be collected directly from patrons of the department incurring it?

How to handle nonpatronage income was given as another area of concern. If certain property owned by the association is sold, how should this nonpatronage income be distributed: As patronage refunds on the basis of current patronage? Or as patronage refunds over an extended period?

The treatment of the large vs. the small patron again brought up questions of equitability vs. equality. Are quantity discounts to large producers equitable? If discounts are too large or too small, are certain patrons subsidizing others?

The problem of recording and distributing small patronage refunds was offering a real challenge to many associations at the local level. Here the question of equal treatment of all types of patrons had to be weighed against the problem of keeping costly and time-consuming records.

Other problem areas included determining proper rates of depreciation and handling noncash refunds. Can accelerated depreciation rates--that is, writing an asset off in 10 years when it may have an estimated life of 15 or 20 years--be justified? Should patrons who do not agree to include noncash refunds as income (nonconsenting patrons) be treated the same as consenting patrons?

* * * * * * * * *

Patronage refunds are widely accepted by patrons as a measure of cooperative success. There is, however, a growing complexity in patronage refund procedures--stemming from expansion and diversification of cooperative activities--which presents possibilities for misunderstanding unless members are fully informed. Thus, through the patronage refund system, cooperatives have an excellent educational vehicle for explaining their operating methods and policies to members and patrons.

Enlightened cooperative management will take time to explain how patronage refunds are computed and distributed. Members and other patrons leave with a much better knowledge of how their association operates.

This report is the forerunner of more extensive FCS research into methods and procedures farmer cooperatives use in making patronage refunds. Its purpose is to supply information and insight into current policies followed by cooperatives in distributing net savings to patrons on a patronage basis. In examining these patronage refund policies and procedures, this preliminary report has raised many questions. It has attempted to achieve a workable definition of patronage refunds meaningful to both marketing and farm supply cooperatives.

It has also considered briefly the agreements setting forth refund obligations, other deductions from net savings that take precedence over patronage refunds, how such

refunds are figured, and the importance of division of operations in achieving equity in refund computation and distribution. This report, in addition, has touched on the various problems about patronage refunds which concerned the cooperative officials interviewed.

As a result of this report and data obtained from mail questionnaires, FCS will evaluate further the equitability of present patronage refund methods and procedures and will make recommendations for improvement where necessary.

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